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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 815

THE OHIO CASUALTY INSURANCE CO., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. 18–22) is unreported. The opinion of the court of appeals (Pet. 23–27) is reported at 399 F.2d 387.

JURISDICTION

The judgment of the court of appeals was entered on September 9, 1968. The petition for a writ of certiorari was filed on December 7, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the courts below correctly found that the obligee of a surety bond covering the storage of

agricultural commodities had no knowledge of any shortages of such commodities in the assured's warehouse prior to the issuance of the bond and a rider thereto.

2. Whether a compensated surety is released from its obligation when the obligee fails to give the surety information regarding the assured which is not directly related to shortages and which the surety did not request by the terms of the surety agreement or otherwise.

STATEMENT

On June 30, 1960, the Commodity Credit Corporation ("CCC") entered into a storage agreement with a public warehouseman, Ross Elevators, Inc. ("Ross") for the storage of agricultural commodities owned by the CCC. This storage agreement extended a business relationship which had existed continuously since 1939 (App. 11b).[1] There had never been any default or other unsatisfactory performance by Ross under the earlier agreements; the only problems which had arisen were minor, caused by the CCC's errors or loss of records (App. 12b–13b). For example, the June 14, 1960 meeting of the CCC's local "shortage committee"—a body created under local office procedures to inquire into and resolve any issues regarding warehoused grain—was concerned with the loss of warehouse receipts issued by Ross in 1957 for less than $3,000 worth of commodities; the committee decided

[1] "App." references with the suffix "a" are to the appendix to appellant's brief in the Sixth Circuit. "App." references with the suffix "b" are to the appendix to appellee's brief in that Court.

to accept copies of receipts supplied by Ross if further efforts to locate the receipts proved unsuccessful (Pet. 28–29). There was no suggestion at this shortage committee meeting that there was any shortage of a stored commodity or other fault on Ross' part.

The June 30, 1960, storage agreement provided, in part, that for the benefit and protection of the CCC, Ross was to keep specified written records regarding commodities stored; the CCC was to have a right to inspect these records as well as the storage facilities and inventory; and Ross was to obtain a surety bond, naming the CCC as obligee, to cover any shortages of CCC agricultural commodities it stored (App. 24b–25b). Petitioner was not a party to this agreement.

On July 21, 1960, Ross obtained a surety bond of $15,000 from the petitioner surety company. Petitioner had had a $24,000 bond with Ross to cover the storage of grain by Ross under other storage agreements with the CCC for at least eight years prior to this date, so that the new bond in effect reduced petitioner's liability (App. 10b–11b, 13b). Petitioner made no inquiries of the CCC or other investigation regarding Ross' performance before issuing the new bond. Ross, as principal, and the petitioner, as surety, were the sole parties to the new bond (App. 26a).

The $15,000 surety bond agreement "firmly bound" the petitioner "unto Commodity Credit Corporation and to any * * * person who may be injured by a breach * * *" of the June 30, 1960 storage agreement (App. 24a). It contained no requirement that

the CCC notify the surety of non-performance or default by Ross of any provision of the storage agreement. Nor did it require either Ross, as principal, or the CCC, as obligee, to provide information regarding Ross' performance. Under the surety agreement, the petitioner expressly waived any right to notice of modification of the storage agreement between the CCC and Ross (App. 25a). A rider to the surety bond agreement was executed on March 7, 1962; for consideration, it increased the amount of the bond by $4,000, to $19,000 (App. 27a-28a).

Pursuant to its right under the storage agreement, the CCC periodically visited Ross' facilities and examined its records—for example, in March, July and December of 1961 (App. 5b). None of these inspections disclosed any shortage of grain (App. 2b, 3b–4b, 7b–9b, 12b). The only irregularity revealed, in the March and July 1961 inspections, was that Ross was not keeping required daily records; a report to this effect was sent to the CCC office (App. 5b–7b).

A shortage of grain was discovered for the first time in the CCC's long association with Ross on July 20, 1962, when a CCC inspector found a shortage of commodities well in excess of the bond during the course of a routine inspection of Ross' facilities and records (App. 2b, 8b). When Ross failed to reimburse the CCC, the CCC obtained a judgment for the value of the missing grain—over $65,000. When this judgment was not satisfied, the CCC commenced the present litigation against petitioner upon its $19,000 surety obligation.

In the district court proceedings, petitioner contended that it was released from its surety obligation because the CCC knew, but did not notify it, (1) of shortages of commodities at Ross' facilities prior to the issuance of the $15,000 surety bond and its $4,000 rider and (2) of Ross' failure to keep complete records as required by the storage agreement between the CCC and Ross. The district court found that the CCC had no knowledge of any shortage at Ross' facilities or similar default by Ross under the storage agreement prior to July 20, 1962 (Pet. 21). It held that since the surety agreement contained no provision that the CCC give notice to the surety regarding Ross' "default" in record-keeping, the surety was not discharged by CCC's failure to give such notice (Pet. 22). Accordingly, the district court entered judgment on the surety bond in favor of the CCC.

On appeal, the Court of Appeals for the Sixth Circuit affirmed. Petitioner had contended that even if the district court correctly found that the June 14, 1960 meeting of the shortage committee did not concern any shortage, the simple fact that there was a meeting was significant to the surety's risk, and therefore the CCC had a duty to inform it of the meeting. Similarly, the surety argued that Ross' failure to keep required records should have been disclosed. In rejecting these contentions, the court of appeals found it "well settled" that "there is nothing in the mere nature of the contract of suretyship itself which requires the obligee to disclose to the proposed surety all material facts affecting the risk" (Pet. 26). The court

further held that petitioner would not be released from its obligation even if Ross' failure to keep complete records were to be construed as a default under the storage agreement, absent a provision in the suretyship contract requiring the CCC to inform petitioner of this default; an obligee has no duty independent of the contract to notify the surety of such defaults (Pet. 27). Moreover, the court noted, even if the CCC acquiesced in Ross' failure to keep complete records, thus modifying the storage agreement without the knowledge and consent of the surety, petitioner expressly waived its right to notice of any modification (Pet. 27; App. 25a).

ARGUMENT

The decision of the court of appeals is correct and is not in conflict with any other decision. Furthermore, no important question of federal law is involved. Accordingly, further review is not warranted.

1. The district court found upon considerable evidence (*e.g.*, App. 2b, 4b, 7b–9b, 12b) that the CCC had no knowledge of any shortages at Ross' facilities until July 20, 1962, well after the bond and rider were issued. The district court expressly rejected petitioner's contention, raised again here, that the CCC had notice of a shortage as of the June 14, 1960, meeting of its shortage committee, finding instead that the committee met merely to ascertain the location of $3,000 worth of warehouse receipts it had lost (Pet. 21, 28–29). After reviewing the evidence, the court of appeals concluded that these findings were

not "clearly erroneous" (Pet. 26). This conclusion was justified; in any event, the issue is one not normally reviewed in this Court. *Graver Tank and Mfg. Co., Inc.* v. *Linde Air Products Co.*, 336 U.S. 271, 275; *Berenyi* v. *Immigration Director*, 385 U.S. 630, 635.

2. Petitioner contends that the CCC, as obligee on the surety agreement between petitioner and the principal Ross, had a duty to disclose information about Ross which did not directly involve shortages. Specifically, petitioner argues that the CCC should have informed petitioner of the June 14, 1960, shortage committee meeting and of Ross' failure to keep all the records called for under the storage agreement between Ross and the CCC. The CCC had no duty to disclose this information, however, and petitioner, as a compensated surety, was not released from its obligation.

It is an established rule of suretyship law that "[t]he mere relation of principal and surety does not require the voluntary disclosure of all the material facts in all cases." *Magee* v. *Manhattan Life Ins. Co.*, 92 U.S. 93, 99; see, *e.g.*, *Whitcomb* v. *Shultz*, 223 Fed. 268, 275 (C.A. 2), certiorari denied, 238 U.S. 632; *Howe Machine Co.* v. *Farrington*, 82 N.Y. 121, 126; *Harris and Harris Constr. Co.* v. *Crain and Denbo, Inc.*, 256 N.C. 110, 123 S.E. 2d 590, 598. Therefore, "[i]f the surety desires information, he must ask for it. The creditor [obligee] is not bound to volunteer it." *Magee* v. *Manhattan Life Ins. Co., supra*, 92 U.S. at p. 99; see *e.g.*, *Hartford Accident and Indemnity Co.* v. *State of*

Kansas, 247 F 2d 315 (C.A. 10); *Town of Hamden* v. *American Surety Co.,* 93 F. 2d 482 (C.A. 2), certiorari denied, 303 U.S. 648; *Citizens' Trust and Guaranty Co.* v. *Globe & Rutgers Fire Ins. Co.,* 229 Fed. 326, 330 (C.A. 4).

These rules are based upon the fact that the surety is normally the "friend of the principal." *Harris and Harris Constr. Co.* v. *Crain and Denbo, Inc., supra,* 123 S.E. 2d at p. 598. The surety is sought out by the principal and the surety obligation is written for the principal at his request, with the principal paying the consideration to the surety. The surety and the principal are the only parties to the surety agreement and usually make their arrangements without the presence of the obligee. Accordingly, the surety is expected to look to the principal for any information it deems material and essential regarding the surety obligation. See, *e.g., Magee* v. *Manhattan Life Ins. Co., supra,* 92 U.S. at p. 99; *Citizens' Trust and Guaranty Co.* v. *Globe & Rutgers Fire Ins. Co., supra; Star Ins. Co. of America* v. *Carey,* 126 Kan. 205, 267 Pac. 990; *Watertown Savings Bank* v. *Mattoon,* 78 Conn. 388, 62 Atl. 622; *Harris and Harris Constr. Co.* v. *Crain and Denbo, Inc., supra; Sherman* v. *Harbin,* 125 Iowa 174, 100 N.W. 629, 631.

Of course, the surety may seek additional information from the obligee. However, the surety must specifically request this information; there is no duty upon the obligee to volunteer it. Absent questions directed to the obligee by the surety, or a contract provision to the contrary, an obligee may remain silent

and its failure to seek out the surety and disclose information essential to the surety will not release the surety from its obligation. See, *e.g.*, *Magee* v. *Manhattan Life Ins. Co.*, 92 U.S. 93; *Hartford Accident and Indemnity Corp.* v. *State of Kansas*, 247 F. 2d 315 (C.A. 10); *Town of Hamden* v. *American Surety Co.*, 93 F. 2d 482 (C.A. 2), certiorari denied, 303 U.S. 648; *National Surety Co.* v. *Russell*, 66 F. 2d 104 (C.A. 7); *Citizens' Trust and Guaranty Co.* v. *Globe & Rutgers Fire Ins. Co.*, 229 Fed. 326 (C.A. 4). Because petitioner did not request that the CCC provide it with information in undertaking the surety obligation, either by the terms of the surety agreement or otherwise, the courts below correctly ruled, in accordance with these well-settled principles, that petitioner was not released from its obligation.

3. Petitioner relies solely upon § 124 of the Restatement of Security (1941) to support its position that the CCC as obligee had a duty to disclose to it the CCC's loss of receipts and Ross' deficient record-keeping procedures (Pet. 4). Section 124 provides that under certain circumstances, an obligee must disclose facts that "materially increase the risk." Comments *a*, *b*, and *e* to § 124, however, make clear that information which "materially" increases the risk must be information of such importance and so directly related to the risk that failure to disclose the information constitutes fraud upon the surety. In the case here, of course, the only information found not to have been volunteered to the surety was that the shortage committee met and that Ross kept incom-

plete records. The shortage committee meeting concerned lost receipts, not shortages; Ross' failure to keep complete records did not materially affect the risk to the surety—for the CCC, despite the lack of full records, was able to conduct a thorough examination of Ross' facilities and inventory in 1961 and to determine that there was no shortage (App. 5b–8b, 12b); and in 1962, although full records still were not kept, the CCC was able to discover the shortage.[2]

Finally, there is no reason for this Court to consider whether, in this particular respect, the Restatement position should be adopted for cases involving the government. The question is one which arises infrequently, and the Restatement position, as construed by the petitioner, has achieved no currency in the states. Indeed, sound policy requires rejection of a rule of law which would make it easier for compensated sureties to be released from their obligations. To permit the release of a compensated surety for anything less than clear evidence of fraud or bad faith would make "bonds of this character * * * a very precarious security to the parties who take them." *Bostwick* v. *Van Voorhis,* 91 N.Y. 353, 361; see also *Hartford Accident and Indemnity Co.* v. *State of Kansas,* 247 F. 2d 315, 321 (C.A. 100).

[2] If the Restatement provision should be construed to support the petitioner's position, it is supported by no cases, and would be contrary to the well-established principles of surety law outlined above.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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